

Markets This Week Ahead of the Open

Key Takeaways

- Markets hit record highs this week following investor enthusiasm in tech and semiconductor names
 - Inflationary pressures continue to rise, with this month's CPI & PPI readings hitting record levels
 - Treasury yields rise above the 5% mark, a signal that markets are growing cautious over tighter financial conditions
-

This past week, investors were faced with an extremely volatile macroeconomic backdrop that renewed concerns around geopolitical tensions and inflation. To start the week, President Trump announced that Iran's response to the U. S.'s recent proposal was unacceptable, signaling that the resolution markets had started pricing in since last week, was no longer likely. The following day, the BLS released its CPI report, a report in which headline CPI saw its highest reading since May 2023. Prices were 3.8% higher than the prior year, above the Fed's 2% benchmark. On Wednesday the BLS had also released its PPI report, a report that also came in hotter than expected. Wholesale prices had risen 6% on the year, the largest reading since December 2022. The driving force behind these price increases continued to be rising energy costs, a factor markets remain highly aware of. Despite these concerning readings, markets remained unfazed, as enthusiasm for tech and semiconductor stocks overshadowed the data and pushed the S&P 500 and Nasdaq to reach record highs.

What added fuel to this week's rally was the recent U.S.-China summit, where President Trump, alongside a handful of American CEOs, met with Chinese President Xi Jinping. The Summit showed that the U.S. and China actively continue to work towards stabilizing trade, with the most notable effort being the beginning of talks for the U.S.-China Board of Trade. American CEOs, including Elon Musk and Jensen Huang, also had the chance to meet individually with President Xi, ultimately leading them to collectively applaud his efforts to open China's doors to American business. The final and most important development that came from this meeting was also that both countries agreed that the Strait of Hormuz needed to reopen. The U. S.'s relationship with China has always been tense, but this recent summit showed that this doesn't need to be the case. After this week, it's become clear that both countries are working towards stabilizing their relationship, something that markets have eagerly waited for.

Markets hit record highs on Thursday, but to end the week, this reversed. Renewed inflationary concerns contributed towards another, consecutive, advance in yields, which ultimately brought markets down. A combination of accelerating inflationary pressures and renewed geopolitical tensions has been the driving force behind the advance in Treasury yields. On Friday, 30-year Treasury yields pushed above 5.1%, a move that frightened markets. The last time yields went past this benchmark was in October 2023, a period of time that saw large treasury issuance alongside a more restrictive Fed. After treasuries crossed the 5% mark in 2023, equity markets saw a broad sell-off that compressed valuations across the board. While the sell-off seen on Friday wasn't to the same extent, it still serves as a warning sign. The recent rise in inflationary pressures continues to stem from rising energy prices, and until we move closer towards a resolution in Iran, it can be reasonably expected for this to continue. From the outside it seems as if markets have overlooked this, but this isn't the case. Beneath the surface of this market optimism lies an extremely fragile U.S. economy that could, at any moment, bring markets back down. The cost of borrowing continues to rise and bring discretionary spending down. At the same time, the labor market continues to see layoffs as the integration of artificial

intelligence continues to rise. Our current macroeconomic backdrop isn't the most favorable to equity markets, yet they still continue to outperform. In the long-term it would be rational to think that markets could correct because of this, but in the near-term this isn't the case. Markets have continued to display optimism despite escalated geopolitical tensions and heightened inflation. For now, it's safe to assume this trend continues in the near-term, but this may not be the case in the long-term. Against our current backdrop, the possibility of a more restrictive Fed has been at its highest for the year, and if this becomes the case, then markets may begin to see that correction many have started to anticipate.